

## Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 ARAE-00 SP-02 USIA-06 AID-05 EB-07

NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

LAB-04 SIL-01 L-03 H-02 PA-01 PRS-01 /085 W

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P R 171230Z SEP 76

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC PRIORITY 7881

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

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PASS TREASURY

E.O. 11652: N/A

TAGS: EFIN, BR

SUBJ: BRAZILIAN MONETARY OFFICIALS TIGHTEN CREDIT FURTHER AS  
INFLATION HEATS UP IN AUGUST

1. THE NATIONAL MONETARY COUNCIL, THE BODY RESPONSIBLE FOR  
THE FORMULATION OF MONETARY POLICY IN BRAZIL, ANNOUNCED  
THE FOLLOWING ADDITIONAL CREDIT TIGHTENING MEASURES ON  
SEPTEMBER 15:

A. COMMERCIAL BANKS WILL HENCEFORTH BE ABLE TO USE  
ONLY 2.5 PERCENT OF THEIR COMPULSORY RESERVES REQUIRE-  
MENTS FOR WORKING CAPITAL LOANS TO SMALL AND MEDIUM SIZED  
FIRMS, AS OPPOSED TO THE PREVIOUS 10.5 PERCENT. THIS ACTION  
WILL THUS REQUIRE COMMERCIAL BANKS TO INCREASE THE CASH PORTION  
OF THEIR RESERVE REQUIREMENTS BY 8.0 PERCENTAGE POINTS,  
A SUM ESTIMATED AT CR 9.0 BILLION (ROUGHLY DOLS 800 MILLION  
DOLLARS). TO EASE THE BURDEN, THE CENTRAL BANK IS PERMITTING  
THE COMMERCIAL BANKS TO MAKE THIS CASH TRANSFER IN 8 EQUAL  
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MONTHLY INSTALLMENTS. (COMMERCIAL BANKS ARE REQUIRED TO

CONTINUE TO MAKE THE SAME PERCENTAGE OF LOANS TO SMALL AND MEDIUM SIZED FIRMS).

B. THE PORTION OF COMPULSORY RESERVES HELD IN GOVERNMENT BONDS AND BILLS (ORTN AND LTN) HAS BEEN FROZEN AT THE CURRENT LEVEL (WHICH IS ESTIMATED AT CR 20 BILLION OR ABOUT 1.8 BILLION DOLLARS). SINCE AT THE PRESENT TIME 55 PERCENT OF RESERVES ARE HELD IN THIS FORM, THIS ACTION REPRESENTS AN EQUIVALENT INCREASE IN THE CASH COMPONENT OF ALL FUTURE COMPULSORY RESERVE DEPOSITS MADE BY COMMERCIAL BANKS (THE CASH COMPONENT OF RESERVES IS NOT REMUNERATED). (COMMENT: THE REASON THE CENTRAL BANK DID NOT OPT FOR A STRAIGHT INCREASE IN RESERVE REQUIREMENTS IS THAT THE CURRENT 35 PERCENT IS THE LEGAL LIMIT).

C. FINALLY, INTEREST RATE CEILINGS ON COMMERCIAL BANK LOANS WERE LIFTED, EXCEPT FOR RURAL LOANS AND OTHER CREDITS MADE FROM OFFICIAL SOURCES.

2. COMMENT: THESE LATEST MEASURES WERE TAKEN ON THE HEELS OF THE ANNOUNCEMENT OF THE AUGUST INFLATION RESULTS, WHICH CAME AS A REAL DISAPPOINTMENT TO GOB OFFICIALS. THE INCREASE IN THE GENERAL PRICE INDEX (FOR INTERNAL USE) IN AUGUST WAS 4.1 PERCENT (AS COMPARED TO 3.8 PERCENT IN JULY ), BRINGING THE CUMULATIVE INCREASE THIS YEAR TO 32.5 PERCENT. FOR THE TWELVE MONTH PERIOD ENDING IN AUGUST, THE INCREASE WAS 44.7 PERCENT. UNLESS INFLATION DROPS STEEPLY DURING THE LAST FOUR MONTHS OF THE YEAR, THE YEAR-TO-YEAR INCREASE WILL LIKELY PASS THE 50 PERCENT MARK IN 1976.

3. FINANCE MINISTER SIMONSEN ALSO ANNOUNCED YESTERDAY (SEPTEMBER 15) THAT THE MONEY SUPPLY (M1) THROUGH AUGUST INCREASED BY 11.5 PERCENT (OVER DECEMBER 1975), AS AGAINST 9.0 PERCENT FORESEEN IN THE MONETARY BUDGET. WHILE THE JAN-AUGUST INCREASE WAS NOT ON TARGET, IT WAS NEVERTHELESS A GOOD PERFORMANCE WHEN COMPARED WITH THE EXPERIENCE OF LAST YEAR.

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4. AS THE AUGUST RESULTS INDICATE, INFLATION IS NOT RESPONDING TO THE TIGHT CREDIT MEASURES TAKEN IN THE PAST SEVERAL MONTHS. WHILE SQUEEZING CREDIT FURTHER, AS THE LATEST MEASURES SHOW, THE GOB IS ALSO ADOPTING A MORE RESTRICTIVE ATTITUDE TOWARD PUBLIC EXPENDITURES. DELAYS IN A NUMBER OF MAJOR PUBLIC INVESTMENT PROJECTS (SUCH AS THE RAILROAD MODERNIZATION PROGRAM) HAVE ALREADY BEEN ANNOUNCED. FINMIN SIMONSEN

HAS ALSO STATED THAT NO NEW INVESTMENT PROGRAMS WILL BE UNDERTAKEN UNLESS FUNDS ARE SPECIFICALLY PROVIDED FOR. GOB OFFICIALS ARE APPARENTLY MOVING TOWARD THE ADOPTION OF FISCAL MEASURES TO COMPLEMENT MONETARY ACTIONS IN THEIR FIGHT AGAINST INFLATION.  
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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** CREDIT, INFLATION, ECONOMIC PROGRAMS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 17 SEP 1976  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** greeneet  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1976BRASIL08049  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** N/A  
**Film Number:** D760351-1004  
**From:** BRASILIA  
**Handling Restrictions:** n/a  
**Image Path:**  
**ISecure:** 1  
**Legacy Key:** link1976/newtext/t19760950/aaaabqwd.tel  
**Line Count:** 121  
**Locator:** TEXT ON-LINE, ON MICROFILM  
**Office:** ACTION ARA  
**Original Classification:** LIMITED OFFICIAL USE  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 3  
**Previous Channel Indicators:** n/a  
**Previous Classification:** LIMITED OFFICIAL USE  
**Previous Handling Restrictions:** n/a  
**Reference:** n/a  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** greeneet  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 14 JUL 2004  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <14 JUL 2004 by CunninFX>; APPROVED <27 OCT 2004 by greeneet>  
**Review Markings:**

Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
04 MAY 2006

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** BRAZILIAN MONETARY OFFICIALS TIGHTEN CREDIT FURTHER AS INFLATION HEATS UP IN AUGUST  
**TAGS:** EFIN, BR  
**To:** STATE  
**Type:** TE  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006